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LUMO ENERGY

21 February 2020

Ms Sarah Proudfoot
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Submitted via email: regulatoryinnovation@aer.gov.au

Dear Ms Proudfoot,

Re: Draft Customer Service Incentive Scheme

Red Energy and Lumo Energy (Red and Lumo) welcome the opportunity to provide this submission on the Australian Energy Regulator's (AER) draft decision to introduce a Customer Service Incentive Scheme for electricity networks.

Unlike competitive businesses, regulated monopolies have limited incentives to improve their customer service outcomes, as customers of the electricity network have no choice of provider. As a result, we provide in principle support for the introduction of an incentive that will improve customer service outcomes for energy consumers. We question whether the AER will also introduce an equivalent scheme for gas customers.

However, our support for the introduction of a Customer Service Incentive Scheme is subject to the customer service component of (+-0.5% of a distributor's annual revenue) of the AER's Service Target Performance Incentive Scheme be abolished. In our view, the customer service component of the Service Target Performance Incentive Scheme fails to create the right incentive for networks to earn 0.5% of the annual revenue. It is much too easy for electricity networks to comply with a single performance parameter to extract a financial reward under the scheme.

Additionally, our support is conditional that the design of the Customer Service Incentive Scheme specifically mandates that networks must negotiate with both retailers and customers when identifying priorities and preferences for the scheme. Retailers are not only a distributor's customer in that they pay network charges and pass them on to end users, but they are also customer facing and have a deep understanding of our customer's service expectations. As a result, retailers add significant value to customers in their negotiations with networks.

In relation to the specific design aspects of the Customer Service Incentive Scheme, we support:
- A principles based approach to the Customer Service Incentive Scheme.
- A Customer Service Incentive Scheme that reflects consumer preferences that are discovered through genuine consultation.
- A Customer Service Incentive Scheme with rewards and penalties.

- A default maximum amount of revenue at risk of 0.5% of annual revenue.
- The use of historical performance to set baseline distributor performance.

We note that the incentive scheme should not replace effective compliance monitoring and enforcement by the AER of existing obligations on networks under both the National Electricity Rules and the National Energy Retail Rules. In many instances, these obligations directly influence the services that end consumers receive, such as the time to complete a new connection and other service order requests. Compliance with existing obligations will go a long way towards improving levels of customer service.

Principles based Customer Service Incentive Scheme vs prescriptive schemes

Red and Lumo support the AER's decision to develop a principles based Customer Service Incentive Scheme. A principles based approach would give each network the flexibility to specifically design their Customer Service Incentive Scheme to reflect their end consumer needs. Under this flexible approach, retailers, consumers and networks could work together developing performance parameters and measurement approaches specifically designed for their end consumers.

In contrast, a prescriptive based Customer Service Incentive Scheme that prescribed all of the specific parameters of the scheme upfront and the manner of calculating rewards and penalties would not be appropriate. While such an approach would give certainty to networks upfront, it would lack the flexibility required of a Customer Service Incentive Scheme for it to be effective.

The challenge for the AER will be to determine whether the networks' proposed parameters truly reflect the preferences of end consumers and their willingness to pay for a particular level of service. It will be imperative that the AER ensure that network engagement with retailers and end consumers is genuine and representative of all end consumers, rather than specific segments or consumer representative agencies.

We note the AER and networks' recent experience with the development of cost-reflective tariffs as an example of the challenges in developing regulatory initiatives that reflect consumers' preferences. In our view, some networks proposed very complicated tariffs and associated assignment policies that do not reflect the views of end consumers or appear based on genuine consultation. There is the same potential under this scheme, which would not be in the long term interests of the consumers that it is attempting to assist.

Customer service incentive scheme to include a wide range of performance parameters

Red and Lumo support a Customer Service Incentive Scheme which incentivises networks to comply with a wide range of performance parameters. Currently, the AER's Service Target Performance Incentive Scheme includes a customer service parameter that links +-0.5% of a network's annual revenue to the amount of fault line telephone line calls answered within 30 seconds. In our view, the customer service component of the Service Target Performance Incentive

Scheme fails to create the right incentive for networks to earn 0.5% of the annual revenue. It is far too easy for networks to comply with a basic single performance parameter to extract the financial reward under the scheme.

Penalties and rewards

Red and Lumo support a Customer Service Incentive Scheme that provides both penalties and rewards as consumers are unable to opt for a different electricity network business. Overall, we agree with the AER that a Customer Service Incentive Scheme that both penalises and rewards provides an incentive to spend on customer service when the value of the additional inputs are less than the increased output. An incentive scheme which has been designed this way will deliver efficient outcomes. This is in contrast to a penalty only Customer Service Incentive Scheme that sets the target level of customer service at an efficient level. Identifying the efficient level of customer service will always be difficult under such an approach.

Default maximum amount of revenue at risk

Red and Lumo consider that the maximum revenue at risk of +-0.5% for the Customer Service Incentive Scheme is appropriate. Should end consumers, networks and retailers agree, there may be some limited circumstances for networks to take the maximum revenue at risk +-1% under the Customer Service Incentive Scheme. However, this would require the customer service component of the Service Target Performance Incentive Scheme which equates to 0.5% would need to be abolished.

About Red and Lumo

Red and Lumo are 100% Australian owned subsidiaries of Snowy Hydro Limited. Collectively, we retail gas and electricity in Victoria, South Australia, New South Wales and Queensland, and electricity in the ACT to over 1 million customers.

Should the AER have any enquiries regarding this submission, please call Con Noutso, Regulatory Manager on 0481 013 988.

Yours sincerely

Ramy Soussou
General Manager Regulatory Affairs & Stakeholder Relations
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